In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 342

THE HAYS' CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

In May 1955, in a transaction qualifying as a tax-free "reorganization" under § 368(a)(1)(B) of the Internal Revenue Code of 1954, petitioner acquired all of the stock of the Metrotype Corporation in exchange solely for 5800 newly-issued shares of its own voting stock. The Metrotype stock had a basis in the hands of the transferors of $22,966. Because the transaction was a reorganization, the transferors recognized no gain upon their receipt of petitioner's stock (§ 354(a)) and petitioner took over the Metro-

type stock with the same basis it had in the hands of the transferors (§ 362(b)).

Metrotype became insolvent and was liquidated in 1956, entitling petitioner to deduct as a loss in that year the full amount of its basis in the stock (§ 165 (g)(3)). Under § 362(b) of the Code, as noted above, its basis was $22,966, its transferors' basis. Petitioner contends, however, that the statute is unconstitutional, that it was entitled to recover its "cost" for the stock, and that its "cost" was the fair market value of its own stock issued in exchange for it (allegedly, $46,400). The Tax Court and the court of appeals both upheld a deficiency determined in accordance with the statute.[1]

The basic concept that has guided Congress' treatment of "reorganizations" is that, in such transactions, the transferors retain a continuing interest in the same underlying assets and it is only the form of their ownership that is changed. Because of that continuity of interest, it is deemed appropriate to treat the transaction as neither a "sale" by the transferor (requiring a reckoning up of gain or loss) nor a "purchase" by the transferee (providing a new basis on which to account for future dispositions) and to postpone the tax accounting for any gains or losses until a more definitive severance takes place. Such a specification of the kinds of transactions that will be treated as taxable events is plainly within the

[1] The proceedings actually involve 1957, to which petitioner sought to carry over a part of the loss, but the sole issue is the computation of the loss incurred in 1956.

power of Congress to define "income" for purposes of the Sixteenth Amendment. The petition presents no substantial question and should be denied.

Respectfully submitted.

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SEPTEMBER 1964.

U.S. GOVERNMENT PRINTING OFFICE 1964